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SIPDIS

FROM AMBASSADOR FOR UNDER SECRETARY JEFFERY
STATE FOR E TOM PIERCE
STATE FOR WHA/MEX ELIZABETH WOLFSON AND IAN BROWNLEE

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TAGS: ECON MX
SUBJECT: SCENESETTER FOR UNDERSECRETARY JEFFERY'S VISIT TO
MEXICO JULY 9-11

¶1. (U) My staff and I warmly welcome you to Mexico City. President Calderon recognizes the broad-ranging challenges his country faces and has the vision and political will to address them strategically. He has demonstrated resolve in implementing his key policy objectives: improving security and the rule of law, attacking poverty, and creating jobs. The U.S. and Mexico have developed a solid set of institutional relationships that allow us to work productively on most of our priorities, including fundamental issues of homeland security and North American prosperity. Those links are set to expand. Your visit is a sign of U.S. support for the Calderon government and dedication to this complex, interdependent relationship.

¶2. (U) Mexico's democratic institutions weathered a contentious presidential election in July 2006, and Calderon was quick to emerge as an activist President with a strong and respected cabinet, particularly in the security and economic areas. His security efforts are designed to reassure foreign investors and Mexicans worried about drug-related crime and lawlessness that organized criminals, including pirates and counterfeiters, will no longer act with impunity. He knows that attracting investment is pivotal to curbing migration and narrowing the social and economic inequalities that undercut Mexican society and result in bitter political divisions. Calderon also recognizes that his vision of Mexico becoming a more prosperous country and a regional leader depends first on security and the rule of law.

Bilateral Relations

¶3. (U) Calderon has demonstrated pragmatism in his posture toward the United States and is building on an already modern and mature U.S.-Mexico relationship. The President's message is that Mexico will seek what it needs from us on the basis of equality, respect, and the close cooperation expected of neighbors that share wide-ranging interests and challenges. Our common border, responsible for extensive commercial, community, and family ties, is transforming our societies into two of the most deeply and broadly connected on earth.

Immigration

¶4. (U) Far more than his predecessor, President Calderon recognizes that immigration reform is a U.S. domestic matter that is dependent upon U.S. congressional action. He will seek progress in a low-key effort that avoids making migration the dominant bilateral issue. He places great emphasis on creating opportunities and jobs for Mexicans inside Mexico. President Calderon has publicly said that the solution to the immigration problem is the responsibility of the Mexican government, and must be done by bringing capital to the workers in Mexico, rather than having Mexican labor flow to capital in the United States. Nevertheless, the

Mexican public draws little distinction between documented and undocumented migrants, seeing both as hard-working countrymen who have been driven to the U.S. by domestic economic adversity and U.S. economic demands. As such, domestic political considerations require that Calderon and his cabinet raise the issue with USG officials and that he publicly criticize measures that most Mexicans find offensive. Should the issue arise in your meetings with your Mexican interlocutors, we encourage you to explain U.S. domestic political factors affecting the issue of migration and help your Mexican interlocutors maintain realistic expectations.

15. (U) Similarly, the U.S. border fence is an extremely sensitive issue, and in public settings, Mexican government officials frequently posture against it. Likewise, minor incidents on the border, associated with infrastructure development, can quickly become public disputes. The occasional cases in which Border Patrol agents (often acting in self-defense) injure or kill undocumented aliens inevitably provoke a sharp reaction here. Should the issue arise, we believe it is useful to emphasize that given the rampant violence in the border region -- as well as the threat of international terrorism -- the USG has the responsibility to take all available measures to protect its citizens and enforce its laws.

Security

16. (U) The Calderon administration has moved forcefully to improve public security, significantly increasing the

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security budget; launching surge operations against drug traffickers in six of the most conflictive states; working to overhaul Mexico's national police organization; getting the Congress to pass a major criminal justice reform; and authorizing the extradition to the United States of a record number of wanted criminals, including drug king-pins. The President's actions reflect his commitment to intensify security-related cooperation with the U.S., and his willingness to incur political risk in doing so.

17. (U) The President fully understands the depth of U.S. concerns about international terrorism and the transformational effect of the 9/11 attacks on USG policy, and he has signaled his strong commitment to work with us to preempt terrorist activity or entry through our shared border. While a solid foundation for joint counter-terrorism cooperation has been established, and the Mexican government's efforts should be recognized, we also need to press for further progress on information sharing. With respect to weapons of mass destruction, the Mexican government -- on its own initiative -- has requested our assistance in strengthening its detection capabilities.

18. (U) Mexico is a central partner in USG efforts to combat drug trafficking and other trans-border threats. While taking aggressive measures to tackle organized crime at home, Calderon has also publicly urged the U.S. to boost our own efforts to drive down demand for narcotics and improve controls on arms, cash, and precursor chemicals smuggled into Mexico. He acknowledges that Mexico cannot effectively confront narco-trafficking without our cooperation and is eager for expanded assistance, including help with combating money laundering. During several visits to Mexico, Secretary Chertoff has heard from Mexican Attorney General Medina Mora that Mexico's most critical law enforcement challenges are: improving the institutional strength of local, state, and federal police forces; dismantling the sophisticated business operations run by the drug cartels; and crafting a regional strategy encompassing the U.S., Mexico, and Central America. President Bush recently signed the Merida Initiative, a 450 million USD package that provides funding for technical assistance and equipment for Mexico to use in their fight

against narco-trafficking. This assistance is a key example of our cooperation in the counter narcotics arena.

The Southern Border

¶9. (U) Mexico's southern border remains extremely vulnerable to illegal immigration, trafficking in persons, and the smuggling of all manner of contraband, including drugs/precursors. It is an issue of great concern to the Mexican government, which attributes its lack of success in dealing with the problem to the difficult local terrain; the lack of enforcement infrastructure; the historically informal nature of the border, particularly among local residents; and the inadequate border security efforts of its southern neighbors, Guatemala and Belize. Mexican law enforcement agencies have begun factoring southern border security considerations into ongoing programs and are seeking to expand/improve operations in southern Mexico. Nevertheless, progress in securing Mexico's southern border is of vital importance in achieving our own security objectives.

Strong Leader in a Conflictive Environment

¶10. (U) President Felipe Calderon is showing strong leadership at home and abroad in a manner much appreciated by Mexicans. Although he won election with a bare 36% plurality in a three-way race, a recent opinion poll showed that 62% of Mexicans approve of his performance to date. Nevertheless, the political climate overall remains conflictive, with a congress closely divided between the president's right-of-center National Action Party (PAN), the leftist Democratic Revolutionary Party (PRD), and the left-of-center Institutional Revolutionary Party (PRI). Calderon faces significant domestic challenges in pursuing his security, economic and social reform agendas. At the same time, he must chip away at the historic Mexican ambivalence toward the U.S. that has slowed progress on many common fronts, including security. Because of this divided political environment, it is difficult to predict the results of the mid-term Congressional elections to be held in July 2009. PRD's fortunes seem to be waning and

good showings by PRI candidates in state and local elections over the past year may be a harbinger of strong gains in next year's mid-term elections.

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Stable but Vulnerable Economy

¶11. (U) U.S. strategic interests in Mexico are tied to three key economic factors: (1) a population of 110 million bordering the United States with a poverty rate over 40 percent, (2) the second largest supplier of oil to the U.S. in 2007 (though so far this year it has slipped to third behind Canada and Saudi Arabia), (3) over one billion dollars a day in trade in goods and services, with a highly integrated production cycle between factories in the U.S., Mexico and Canada.

Poverty and Economic Performance

¶12. (U) Mexico has the highest income inequality of any nation in the OECD. The latest Mexican government figures, (from 2006) show the poverty rate declined slightly to 42.6 percent overall, with 10.3 percent living in "food-based poverty," unable to meet the nutritional needs of their families. Widespread poverty encourages illegal immigration, narcotics smuggling to the United States, and other forms of illicit commerce. Growing income inequality fuels the tensions that almost resulted in the election of a populist President, Andres Manuel Lopez Obrador, who openly embraced President Chavez of Venezuela.

¶13. (U) President Calderon inherited a stable, growing economy tightly linked to U.S. economic cycles. Mexico chalked up an estimated 3.3 percent growth rate in 2007, rebounding from near zero growth in the first years of the decade. Real GDP growth is expected to slow to around 2.6 percent this year, primarily due to the U.S. economic slowdown. Inflation, fueled by spiking international food and energy prices, has risen in recent months to over 5 percent, prompting the Central Bank to raise interest rates in June 2008, shortly after the government had reduced import tariffs for key food items, increased subsidies for poor consumers, and obtained voluntary price controls from producers. Most jobs currently being created in Mexico are in the informal economy, which the World Bank estimates employs 27-45 percent of the working age population. Many here are growing concerned about Mexico's ability to compete in an increasingly globalized world, as it loses market share to China and other emerging economies.

Need for Bolder Economic reform

¶14. (U) World Bank, OECD, Mexican and other economists say Mexico would need sustained, long-term growth rates of at least six percent to alleviate widespread poverty -- but cannot achieve that level of growth without structural economic reform beyond what President Calderon has currently proposed. We agree with Finance Minister Carstens that in order to compete internationally and develop the poorest parts of Mexico, Mexico needs broad reform to improve tax collection, reduce reliance on oil income, confront growing pension liabilities and payments on government borrowing outside the federal budget, and provide needed spending on poverty alleviation, education, health and infrastructure. Mexico desperately needs education reform, since currently 60 percent of its people do not graduate high school. In order to achieve sustained robust growth, Mexico must improve competition in an economy long dominated by business monopolies and oligopolies, and to take on powerful labor unions (including the national teachers union) in order to amend labor laws that discourage job creation in the formal economy.

¶15. (U) While President Calderon has achieved more reform in 18 months than his predecessor did in six years, the lack of a majority in Congress has forced him to compromise with the special interests that have long slowed progress in Mexico's economy. While the President's skill at pragmatic political negotiation has led to a series of successful economic reforms, it has also meant the reforms were watered down and are not yet sufficient to place Mexico on a sustained growth path sufficient to alleviate widespread poverty. Reforms to date include a tax reform that solved about one-third of the need for additional collections, and a pension reform that combined with that of his predecessor solved about 80 percent of the insolvency crisis in Mexico's pension systems. To overcome a key to economic growth, President Calderon has announced a National Infrastructure Plan, under which his government would spend five percent of GDP for the next five

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years to improve Mexico's long-neglected infrastructure. The President recently joined with the leader of the national teachers union to announce a program to improve primary education, although many are skeptical that the union will allow real reform. While Calderon's government has taken incremental steps to reduce the market dominance of monopolists and oligopolists in key sectors like telecommunications and banking, Congress has blocked serious reform. Currently, Mexico is in the midst of a heated debate over the President's rather modest energy reform proposal (see below).

Actively Seeking to Expand Trade and Investment

¶16. President Calderon has made increased international trade and investment a cornerstone of his presidency. In June 2007, he created ProMexico, a federal entity charged with promoting Mexican exports around the world and attracting foreign direct investment to Mexico. He has also worked to strengthen economic relations with European and Asian countries in order to lessen Mexico's dependence on the U.S. economy. Last year, Mexico's FDI inflows reached a record 23 billion USD while at the same time the percentage of such inflows originating in the U.S. decreased to 47.3 percent, only the second time since NAFTA implementation that the U.S. has accounted for less than half of Mexico's FDI. Mexico has also seen its percentage of exports to the U.S. decrease from 87 percent in 2004 to 82 percent in 2007. As the U.S.'s economic slowdown continues, Mexico will expand efforts to diversify away from a U.S. centered economy.

¶17. (U) That said, Calderon is eager to deepen commercial integration with the United States and the rest of the region, something his government views as essential to strengthening competitiveness vis-a-vis competitors, especially from Asia. His top officials have reacted positively to our proposal for an Alliance for Growth and Prosperity, though they understand that U.S. domestic politics make progress right now difficult. Mexico sees the August 15 entry into force of the CAFTA-DR textile accumulation provisions as a model for linking together the free trade agreements among common partners in the Hemisphere, and is working with like-minded Latin countries in a group called the Pacific Arc Forum to harmonize rules of origin among common free trade partners.

Energy

¶18. (U) After Canada, Mexico was the largest source of U.S. oil imports last year. We therefore have a strong strategic interest in continued stable supplies of Mexican oil. Within Mexico, energy is an extremely sensitive topic tied to national sovereignty, but the energy sector requires difficult reforms urgently. Mexico's oil production and reserves continue to decline due to a lack of investment in oil exploration and production. Sufficient investment funds are not available because of the constitutional prohibition on private investment and the fact that most of Pemex's revenue goes to pay for as much as 38% of the government's budget. Pemex's liabilities have grown so large that it can no longer fund investment in exploration through borrowing in international markets. President Calderon understands that declining oil production can only be addressed through fiscal reform to reduce the amount of Pemex revenue sucked into the government budget, and through energy reform to improve the efficiency of Pemex operations and allow for private and foreign investment in the petroleum sector. A comprehensive tax reform package was passed last year and there is currently a mild energy reform package being heatedly debated in the Mexican Congress as well as in the court of public opinion. While the package that the Calderon administration submitted to Congress would not open Pemex up to the level of investment that it sorely needs, it seems to be a small but important step toward the large task of reforming Pemex. While polls indicate that most Mexicans now understand something needs to be done with PEMEX, unions and opposition parties reflect the views of many Mexicans who are skeptical of foreign involvement. Even seemingly benign, factual statements by U.S. officials about Mexico's petroleum sector, such as those made by President Bush in March 2007 or Former Fed Chairman Greenspan several months later set off a tempest of responses and front page condemnations, including from officials largely supportive of opening the sector.

Improving North American Competitiveness

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119. (U) Under NAFTA, the industrial production cycle in the U.S., Canada and Mexico has become tightly integrated with factories in each country dependent of parts suppliers in the others. Bilaterally and under the auspices of both the NAFTA and the trilateral Security and Prosperity Partnership of North America (SPP), we are to improve North American competitiveness. Numerous studies and trade groups, including the North American Competitiveness Council, the private sector component of the SPP, have stressed that border facilities and procedures must be improved significantly to accommodate current trade flows and expected future growth. We can make the needed improvements while protecting U.S. security by, inter alia: extending and/or synchronizing operating hours at U.S. and Mexican facilities at the same border crossing; sharing best practices among ports of entry; cutting back on redundant inspections; employing new technologies to track and speed the secure movement of cargo; identifying critical infrastructure investments needed on both sides of the border; and involving the private sector to make the North American supply chain more secure and efficient. At the March 2007 summit between Presidents Bush and Calderon, both governments agreed to increase efforts to facilitate legitimate trade across the border. In response, the U.S. and Mexican governments formed a senior-level working group that has reached out to both public and private sector border residents to solicit solutions to the bottlenecks that stifle border trade. The group has implemented a series of short term measures, including the addition of better dividers between lanes, an increase in signage, and better coordination of operating hours at certain ports of entry. Now the group plans to work on medium and long term solutions such as coordinated infrastructure planning and port of entry expansions.

120. (U) At their April 2008 Summit, the three North American Leaders called for greater progress under the SPP Regulatory Cooperation Framework to make regulations more compatible in order to support integrated supply chains. They called for an increased focus on reducing congestion and bottlenecks at our common borders and improving long range coordination on border infrastructure. The Leaders also called for greater efforts under the SPP Intellectual Property Action Strategy. The USG already has a robust program of bilateral engagement with Mexico on improving its protection of intellectual property rights. The three Leaders also reiterated their support for a comprehensive and ambitious conclusion to the Doha round of WTO negotiations.

Climate Change

121. (U) On May 25, 2007 President Calderon announced Mexico's National Climate Change Strategy. The centerpiece of the Climate Change Strategy is the ambitious and well-funded PROARBOL program which aimed to plant 250 million trees in Mexico in 2007 to stop the decades-long deterioration of Mexican forests. President Calderon has publicly stressed that developing countries should not use the fact that the brunt of the responsibility for climate change lies on the developed countries as an excuse to avoid their commitments to the environment. He emphasized the importance of building an international regime to address climate change. Criticizing the joint implementation and the clean development mechanism of the Kyoto Protocol, Calderon said the international community cannot limit itself to implementing mitigation actions where they are less expensive. High-emitting countries must do more than buy developing country emission credits but must actively reduce their own emissions.

122. (U) President Calderon followed his Climate Change Strategy one week later by announcing the National Development Plan, which highlights environmental sustainability as one of its five focus areas and notes Mexico's potential as an effective intermediary between developing and developed countries in dialogue and

cooperation on sustainable development. The first of two goals listed under "climate change" is to reduce emissions of green house gases (GHG) through energy efficiency measures (including innovative housing designs) and the use of clean technologies. Other GHG reducing measures include the adoption of international standards on vehicle emissions and energy generation from waste. The second goal deals with promoting climate change adaptation measures. Among others, the Plan proposes to assess vulnerabilities, develop different climate change scenarios, including adaptation in

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future planning, protecting coastal buffer areas, evaluating economic and environmental impacts of climate change, and educating the public. No numerical targets are listed under the climate change section.

U.S. Assistance

¶23. (U) Our official U.S. assistance budget for FY08 is USD 50.6 million, a 13.7 percent cut from FY06, and funds much of our efforts to help the Calderon government fight crime, secure borders, reform the justice system, increase economic opportunity, and protect the environment. Just as the President has demonstrated commitment to work collaboratively with the U.S. on a broad agenda, an increasing number of Mexican state governors are working constructively with both U.S. federal agencies and border states to achieve common goals. Of our total USD 50.6 million in official assistance, USAID manages USD 22.8 million in projects that support overall U.S. efforts to address two key causes of migration pressure: lack of economic opportunity and weak public safety. USAID projects work directly with Mexican institutions (including NGOs) at the federal, state, and local levels to: introduce market-based financing for state and local infrastructure; increase access to financial services; increase economic opportunities at home; strengthen security; raise Mexican competitiveness via policy and regulatory reform; improve the judicial system; expand access to credit; and link marginalized producers in poorer areas to national and international markets. Education and health programs also build the capacity of Mexico's work force.

Consular Issues

¶24. (U) One of the clearest indicators of the deep links between our two societies is our consular workload in Mexico. About one third of all USG employees stationed in Mexico are dedicated to providing consular services. An estimated one million American citizens reside in Mexico and about 12 million visit every year. Most Americans rarely encounter problems here, but each year hundreds are arrested, assaulted, die, fall ill, or become destitute, and seek assistance from consular employees. More abductions of U.S. citizen children take place (in both directions) between the U.S. and Mexico than anywhere else in the world. The migration of U.S. citizen retirees to Mexico has provided impetus to improve property rights protections in Mexico, including the introduction of title insurance offered by U.S. insurance companies. The air phase of the Western Hemisphere Travel Initiative went into effect January 23 with few problems and 99 percent of U.S. citizen passengers bound for the U.S. carried passports. The land and sea phase, which will go into effect before June 2009, will present a greater challenge due to the fact that there may be as many as 700,000 U.S. citizens residing in Mexico without documentation who will need passports.

¶25. (U) U.S. Consular Sections in Mexico processed about 1.3 million nonimmigrant visa applications in fiscal year 2006, including 114,000 temporary worker (H2) visas (71 percent of the world total), of which almost 35,000 were temporary agricultural workers (92 percent of the world total). There are no numerical limits on temporary agricultural worker

visas and Mission Mexico stands ready to process much greater numbers of these visas if U.S. agribusiness chooses to make greater use of this program. All immigrant visas in Mexico are issued in Ciudad Juarez, where we processed about 86,000 immigrant visa applications in 2006, of which 54,000 were issued. This is the greatest number of immigrant visas issued to any one nationality in the world. This fluid legal movement of Mexicans northward, along with long-standing documented and undocumented communities in the U.S., makes the USD 23 billion in remittances that Mexicans send home Mexico's second largest source of foreign exchange revenues, behind petroleum and now ahead of both foreign direct investment and tourism.

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